

**IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

**IRVIN S. LIEBERMAN, and all others  
similarly situated,  
Plaintiffs**

**v.**

**CAMBRIDGE PARTNERS, LLC and  
J.B. HANAUER & COMPANY.  
Defendants**

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**CIVIL ACTION  
NO. 03-2317**

**MEMORANDUM OPINION**

**RUFE, J.**

**December 16, 2003**

This federal securities litigation comes before the Court on Defendant J.B. Hanauer & Company's Motion to Dismiss. For the reasons below, the Motion is granted. In addition, the Court dismisses all claims against Defendant Cambridge Partners, LLC because Plaintiff failed to serve that Defendant in a timely manner.

**I. BACKGROUND**

Plaintiff Irvin S. Lieberman, a Pennsylvania resident, brings this putative class action pursuant to Sections 12(a) and 15 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77l(a) and 77o. Plaintiff claims he purchased debt securities issued by the Allegheny County Industrial Development Authority ("ACIDA") pursuant to a prospectus allegedly containing false and misleading statements. Complaint ¶¶ 1, 15, 22-32. Defendants are two underwriters associated with ACIDA's bond offering: Cambridge Partners, LLC ("Cambridge Partners"), a New York corporation, and J.B. Hanauer & Company ("Hanauer"), a New Jersey corporation. *Id.* ¶¶ 5-6. Only Defendant Hanauer has appeared in this case. Jurisdiction is premised on diversity of citizenship

and the Securities Act. See 15 U.S.C. § 78aa, 28 U.S.C. §§ 1331, 1332(a).

ACIDA issued bonds in April 1998 in order to fund a loan to Lanchester Energy Partners, L.P. (“LEP”). LEP used the loan proceeds to finance landfill gas recycling projects at three sanitary landfills. Complaint ¶¶ 16-17. Each project involved the purchase and installation of equipment for recycling and processing naturally-generated landfill gas into commercially valuable methane gas. Id. ¶ 18. According to the prospectus attached to Defendant’s Motion at Exhibit C (the “Official Statement”), the bonds were to be serviced and repaid from the revenues generated by the sale of methane gas and from tax credits for alternative fuels available under Section 29 of the Internal Revenue Code, 26 U.S.C. § 29. Official Statement at 20-25, 30-31.<sup>1</sup>

Plaintiff purchased \$25,000 in ACIDA bonds on April 21, 1998 and alleges that he has sustained “substantial damages.” Complaint ¶ 4. He claims that the Official Statement contains several material misrepresentations and omissions and seeks relief under Sections 12(a)(2) and 15 of the Securities Act. Complaint ¶¶ 7, 34-37, 40.

Defendant Hanauer moves to dismiss the Complaint on three grounds. First, it moves to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(5) for failure to serve the Complaint in compliance with either the Federal or Pennsylvania Rules of Civil Procedure. Second, it moves to dismiss for failure to state a claim under Section 12(a)(2) of the Securities Act. Finally, it moves to dismiss for failure to state a claim under Section 15 of the Securities Act because Section 15 liability is derivative of Plaintiff’s deficient underlying Section 12(a)(2) claim.

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<sup>1</sup> When ruling on a motion to dismiss for failure to state a claim, in addition to the complaint, the Court may consider a document that is integral to or relied upon in the complaint. In re Rockefeller Ctr. Props. Sec. Litig., 184 F.3d 280, 287 (3d Cir. 1999). Here, the Court may consider the Official Statement because alleged misrepresentations and omissions therein serve as the basis for Plaintiff’s Complaint.

## II. DISCUSSION

For purposes of today's decision, and in the interests of judicial economy, the Court will assume that Plaintiff properly served Hanauer. The Court will focus its analysis on whether the Complaint fails to state a claim under Sections 12(a)(2) and 15 of the Securities Act.<sup>2</sup>

### A. Section 12(a)(2) of the Securities Act

Hanauer contends that it cannot be held liable under Section 12(a)(2) of the Securities Act because the debt securities Plaintiff claims to have purchased were issued by a public instrumentality of the Commonwealth of Pennsylvania, and that such securities are expressly exempt from Section 12(a)(2)'s liability provisions.<sup>3</sup> Hanauer bears the burden of showing that the bonds are exempt from the Securities Act. See SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953). Section 12(a)(2) imposes liability on

Any person who . . . offers or sells a security (whether or not exempted by the provisions of section 77c of this title, ***other than paragraphs (2) and (14) of subsection (a) of said section***), . . . by means of a prospectus . . . which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements. . . not misleading . . . .

15 U.S.C. § 77l(a)(2) (emphasis added). Accordingly, securities described at 15 U.S.C. § 77c(a)(2) are exempt from liability under Section 12(a)(2). According to § 77c(a)(2), also known as Section

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<sup>2</sup> The familiar standard governing 12(b)(6) motions applies here. The Court must take all the well pleaded allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable reading of the pleadings, the plaintiff may be entitled to relief. Colburn v. Upper Darby Township, 838 F.2d 663, 665-66 (3d Cir. 1988). A Rule 12(b)(6) motion will be granted only when it is certain that no relief could be granted under any set of facts that could be proved by the plaintiff. Ransom v. Marrazzo, 848 F.2d 398, 401 (3d Cir. 1988).

<sup>3</sup> Defendant advances two alternative arguments for dismissal: (1) that Plaintiff's claims are time-barred under Section 13 of the Securities Act, 15 U.S.C. § 77m, and the Sarbanes-Oxley Act of 2002, 28 U.S.C. § 1658; and (2) that the Official Statement disclosed all of the material risk factors that Plaintiff claims were concealed. Because the Court concludes that the bonds at issue are exempt from liability under Section 12 of the Securities Act, the Court does not reach these arguments.

3(a)(2) of the Securities Act, “[a]ny security issued or guaranteed by . . . any State of the United States, or by any political subdivision of a State . . . or by any *public instrumentality* of one or more States. . . .” is exempt from the Securities Act. 15 U.S.C. § 77c(a)(2) (emphasis added); see also Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 571 (1995) (“By its terms, § 12(2) [now Section 12(a)(2)]<sup>4</sup> exempts from its coverage prospectuses relating to the sales of government-issued securities.”).

Plaintiff does not dispute that ACIDA is a “public instrumentality,” nor could he. See 73 P.S. § 376(a) (West 2003) (“Every industrial and commercial development authority incorporated under this act shall be a public instrumentality of the Commonwealth and a public body corporate and politic . . . .”); Basehore v. Hampden Indus. Dev. Auth., 248 A.2d 212, 216 (Pa. 1968) (“There is no question that the [Industrial Development] Authorities are instrumentalities of the Commonwealth.”). Plaintiff argues instead that the bonds at issue are subject to Securities and Exchange Commission (“SEC”) Rule 131(a) and therefore are excluded from Section 3(a)(2)’s exemption.

SEC Rule 131(a) provides:

Any part of an obligation evidenced by any bond, note, debenture, or other evidence of indebtedness issued by any governmental unit specified in section 3(a)(2) of the Act which is payable from payments to be made in respect of property or money which is or will be used, under a lease, sale, or loan arrangement, by or for industrial or commercial enterprise, shall be deemed to be a separate security within the meaning of section 2(l) of the Act, issued by the lessee or obligor under the lease, sale or loan arrangement.

17 C.F.R. § 230.131(a). Distilled to its essence, SEC Rule 131(a) provides that any security issued

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<sup>4</sup> Congress renumbered Section 12 of the Securities Act in 1995 when it added another subsection. See Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 105, 109 Stat. 737, 757 (codified at 15 U.S.C. § 77I).

by a government entity involving a lease agreement between it and a private entity is deemed to be two separate securities, with both entities considered to be separate issuers of securities.<sup>5</sup> The agreement between the government entity and the private entity is a separate security subject to the coverage of the Securities Act, including the liability provisions in Section 12(a)(2). Plaintiff argues that the bonds were issued to make a loan to LEP for a wholly private venture. He further argues that because LEP's agreement with ACIDA requires that revenues from methane gas sales be used to service and repay the bonds, the agreement is a "separate security," and therefore Rule 131(a) brings ACIDA's bond issue back within Section 12(a)(2)'s liability provisions.

Plaintiff's argument misses one key component of the ACIDA bonds at issue here: they are tax-exempt, and thus are still excluded from Section 12(a)(2)'s liability provisions. Section 3(a)(2) of the Securities Act exempts "any security which is an industrial development bond . . . the

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<sup>5</sup> One court has explained the rationale for SEC Rule 131 accordingly:

Rule 131 was promulgated to deal with problems created by certain revenue bonds, in particular industrial development bonds, which generally involve a government entity issuing bonds to finance the construction of a facility that is then leased to a private entity, with the lease payments providing the sole revenue source to pay off the bondholders. Prior to Rule 131, revenue bonds were exempt from registration under federal securities law because they are technically issued by a government entity. However, revenue bonds are not backed in any way by the taxing authority of the particular government entity like general obligation bonds are. Thus, revenue bonds were exempt from registration, but did not have the commitment of repayment that general obligation bonds have. Since this obligation or guarantee of repayment provided by a government's taxing authority is the primary reason government bonds were allowed to be exempt from registration, Rule 131 was enacted to exclude revenue bonds from the exemption provisions since they did not have the same public commitment as general obligation bonds.

McKay v. Juran & Moody, Inc., No. Civ.A.3-97-86, 1998 WL 1780694, at \*5 (D.N.D. Sept. 1, 1998) (citing Thomas Lee Hazen, 1 The Law of Securities Regulation § 4.3 (3d ed. 1995); Louis Loss and Joel Seligman, Fundamentals of Securities Regulation, pp. 268-72 (3d ed. 1995)); see also Notice of Proposed Rule 131 Under the Securities Act of 1933 and Proposed Rule 3b-5 Under the Securities Exchange Act of 1934, 1968 WL 87384, at \*1, SEC Release No. 33-4896 (Feb. 1, 1968) ("Since the purchaser of an industrial revenue bond looks principally, if not entirely, to the lease payments for the payment of principal and interest on the bond, he is really purchasing an interest in the lease obligation of the private company. The new rules are proposed for the purpose of identifying the interest in the obligation of the private company as a separate 'security' issued by the private company.").

interest on which is excludable from gross income under section 103(a)(1) of Title 26 if, by reason of the application of paragraph (4) or (6) of section 103(c) of Title 26<sup>6</sup>] . . . paragraph (1) of such section 103(c) does not apply to such security.” 15 U.S.C. § 77c(a)(2). Congress added this provision of Section 3(a)(2) in 1970 in response to SEC Rule 131. See Industrial Revenue Bonds, SEC Release No. 33-5103, 1970 WL 5620, at \*1 (Nov. 23, 1970). As the SEC explained, the effect of the amendment was to “exempt from the registration requirements of the [Securities Act], any issue of industrial revenue bonds issued for certain specified purposes . . . [including those relating to] solid waste disposal facilities.” Id. at \*1-2.

Hanauer contends that the ACIDA bonds fit within Section 3(a)(2)’s exemption because they are tax-exempt industrial development bonds issued to construct and operate a gas recycling project that qualifies as a solid waste disposal facility. The Official Statement clearly states that the interest on the ACIDA bonds “is excludable from gross income for federal tax purposes,” and reference to the Internal Revenue Code supports this conclusion. Official Statement at 38. Under Internal Revenue Code §§ 103(a) & (c)(1), the interest payable under the ACIDA bonds is excluded from gross income because it is an obligation of a political subdivision of Pennsylvania. See 26 U.S.C. §§ 103(a), (c)(1). There are some limited exceptions, but none applies here. Section 103(b)(1) makes taxable “[a]ny private activity bond,” which Hanauer apparently concedes includes the ACIDA bonds, but it also excludes “qualified bond[s]” as defined in Internal Revenue Code § 141. A “qualified bond” includes any private activity bond that is “an exempt facility bond.” 26 U.S.C. § 141(e)(1)(A). The term “exempt facility bond” is defined as “any bond issued as part of

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<sup>6</sup> These references to Title 26 are to the Internal Revenue Code of 1954, which have been recodified at 26 U.S.C. §§ 103, 141-151. See discussion infra.

an issue 95 percent or more of the net proceeds of which are to be used to provide . . . (6) solid waste disposal facilities. . . .” 26 U.S.C. § 142(a)(6).

Hanauer contends that the ACIDA bonds fit squarely within this definition, and the Court agrees. Proceeds from sale of the ACIDA bonds were loaned to LEP to finance “the purchase and installation of plant and equipment necessary to recycle and process landfill gas produced at three landfills into pipeline quality gas.” Official Statement at 5. Internal Revenue Service regulations explain that § 142(a)(6)’s reference to “solid waste disposal facility” embraces this kind of project:

In the case of property which has both a solid waste disposal function and a function other than the disposal of solid waste, only the portion of the cost of the property allocable to the function of solid waste disposal . . . is taken into account as an expenditure to provide solid waste disposal facilities. ***A facility which otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid waste disposal merely because material or heat which has utility or value is recovered or results from the disposal process. Where materials or heat are recovered, the waste disposal function includes the processing of such materials or heat which occurs in order to put them into the form in which the materials or heat are in fact sold or used,*** but does not include further processing which converts the materials or heat into other products.

26 C.F.R. § 17.1(a) (2003) (emphasis added). The facilities funded by the ACIDA bond issue were expected to capture and process naturally generated landfill gas into commercially valuable methane gas. In light of the above-quoted regulation, undoubtedly such a project conforms to the IRS’s interpretation of “solid waste disposal facility.” See also SEC Release No. 33-5103, 1970 WL 5620, at \*2 (Section 3(a)(2) “removes from the registration requirements of the Acts, industrial development bonds, substantially all of the proceeds of which are to be used to provide . . . sewage or solid waste disposal facilities”).

Although not cited by the parties, the Court’s own research has revealed that other

courts, when presented with similar arguments, have reached the same conclusion. See In re Bexar County Health Facility Dev. Corp. Sec. Litig., 125 F.R.D. 625, 633-35 (E.D. Pa. 1989) (denying class certification, determining that Section 3(a)(2) exempts the securities at issue from Section 12(2) liability, and concluding that SEC Rule 131 does not apply where proceeds of bond sale were for a loan to a tax-exempt non-profit); Gorsey v. I.M. Simon & Co., Inc., Civ. A. No. 86-1875-Z, 1987 U.S. Dist. LEXIS 1940, at \*7-11 (D. Mass. Feb. 23, 1987) (dismissing plaintiffs' Section 12(2) claims, agreeing with defendants that the notes at issue were exempt from Section 12(2) because of the exceptions in Section 3(a)(2) for bonds issued by a political subdivision of a state and/or tax-exempt industrial development bonds, and concluding that SEC Rule 131 does not apply).

For the foregoing reasons, the Court agrees with Hanauer that the ACIDA bonds are tax-exempt "industrial development bond[s]" within the meaning of Section 3(a)(2) of the Securities Act, that SEC Rule 131 does not apply, and that the ACIDA bonds are exempt from the liability provisions of Section 12(a)(2) of the Securities Act. Accordingly, the Court must dismiss Plaintiff's claims premised on Section 12(a)(2). Because amendment of the Complaint would be futile, the dismissal is with prejudice. Having concluded that Plaintiff's Section 12(a)(2) claims fail because the ACIDA bonds are exempt, the Court need not reach Plaintiff's alternative arguments as to the statute of limitations or the sufficiency of the Official Statement's disclosures.

#### **B. Section 15 of the Securities Act**

Section 15 of the Securities Act imposes liability on any person who "controls any person liable under sections 77k [§ 11] or 77l [§ 12]." 15 U.S.C. § 77o. Liability under Section 15, therefore, is predicated on the presence of liability of a controlled person under Sections 11 or 12. In re U.S. Interactive, Inc. Class Action Sec. Litig., No. 01-CV-522, 2002 WL 1971252, at \*5 n.7



(E.D. Pa. Aug. 23, 2002); Gannon v. Continental Ins. Co., 920 F. Supp. 566, 575-76 (D.N.J. 1996); Jenkins v. Fidelity Bank, 365 F. Supp. 1391, 1402 (E.D. Pa. 1973). Plaintiff does not allege any violation of Section 11 in his Complaint. Having concluded above that Plaintiff cannot make out liability under Section 12, his claims arising under Section 15 must also be dismissed.

**C. Claims Against Defendant Cambridge Partners**

Plaintiff named Cambridge Partners as a defendant to this action, but failed to serve it within the time period provided in Federal Rule of Civil Procedure 4(m). On August 25, 2003, the Court issued an Order to Show Cause why this action should not be dismissed for failure to effect service in a timely fashion. Plaintiff responded by filing an executed summons as to Defendant Hanauer but explained that his efforts to locate Cambridge Partners were unsuccessful. Plaintiff stated that he would file an appropriate motion, presumably asking for more time to serve Cambridge Partners, but no such motion ever appeared on the case docket. Accordingly, the Court dismisses the claims against Cambridge Partners.

An appropriate Order follows.

**IN THE UNITED STATES DISTRICT COURT  
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**IRVIN S. LIEBERMAN, and all others  
similarly situated,  
Plaintiffs**

**v.**

**CAMBRIDGE PARTNERS, LLC and  
J.B. HANAUER & COMPANY,  
Defendants**

**CIVIL ACTION  
NO. 03-2317**

**ORDER**

**AND NOW**, this 16th day of December, 2003, upon consideration of Defendant J.B. Hanauer & Company's Motion to Dismiss the Complaint [Doc. # 6], Plaintiff's Opposition thereto [Doc. # 11], Defendant's Reply [Doc. # 12], and for the reasons set forth in the attached Memorandum Opinion, it is hereby **ORDERED** that Defendant's Motion is **GRANTED**. All claims against Defendant J.B. Hanauer & Company are **DISMISSED WITH PREJUDICE**.

It is further **ORDERED** that all claims against Defendant Cambridge Partners, LLC are **DISMISSED WITHOUT PREJUDICE** for failure to serve the Complaint within the time permitted under Federal Rule of Civil Procedure 4(m).

The Clerk of Court shall mark this case closed for statistical purposes.

It is so **ORDERED**.

**BY THE COURT:**

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**CYNTHIA M. RUFE, J.**